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NAVAL POSTGRADUATE SCHOOL

MONTEREY, CALIFORNIA

MBA PROFESSIONAL REPORT

An Evaluation of Transforming the
Obligation Period for the DOD
Operations and Maintenance Account

By: Stanley S. Dimirack
Timothy V. Lott
December 2005

Advisors: Lawrence R. Jones,
Jerry L. McCaffery

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**AN EVALUATION OF TRANSFORMING THE OBLIGATION PERIOD FOR THE
DOD OPERATIONS AND MAINTENANCE ACCOUNT**

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Submitted in partial fulfillment of the requirements for
the degree of

MASTER OF BUSINESS ADMINISTRATION

from the

**NAVAL POSTGRADUATE SCHOOL
December 2005**

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AN EVALUATION OF TRANSFORMING THE OBLIGATION PERIOD FOR THE DOD OPERATIONS AND MAINTENANCE ACCOUNT

ABSTRACT

Combating negative public perceptions about wasteful, end-of-year spending is not a battle the Department of Defense (DOD) should have to fight. DOD's best intentions are to be good custodians of taxpayers' dollars, but old archaic policies hamper its ability to efficiently obligate current year funding. This project report will provide necessary background, analyze previous O&M obligation rates, discuss the advantages and disadvantages of extending the obligation period for one-year appropriations from one to two years and make recommendations based on the conclusions drawn from our data analysis. The conclusions drawn from our report will reveal the overwhelming benefits DOD would achieve from changing current policy and how the Legislative and Executive branches resist change.

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I. ONE-YEAR APPROPRIATION EXTENSION PROPOSAL EVALUATION

A. INTRODUCTION

1. Specific Issues and Questions this Research will Address

The purpose of this paper is to determine budgetary advantages and disadvantages of extending the obligation period of one-year appropriations, specifically Operations and Maintenance (O&M), to two years (24 months). We will discuss how changing the obligation period would reduce suspected end-of-fiscal-year spending waste. In addition, we will discuss how perceived wasteful spending is directly linked to inefficient use of the time of accountants, budget analysts and comptrollers.

2. Focus: DOD Operation and Maintenance Appropriations

As Mark Kozar stated, "Critics of the DOD claim that appropriated funds are wasted by DOD managers when they rush to obligate all available funds before the end of the year" (Kozar, 1993, page 132-133). The Navy and DOD have dealt with this perception over the course of many years and especially during wartime. The military environment is anything but routine, and just as the DOD is currently dealing with the war on terrorism, every comptroller and Supply Officer is independently preparing for the next contingency. This situation is aggravated by DOD's involvement in ongoing missions. In other words, financial personnel are scrutinizing every obligation during the first three quarters and most of the fourth quarter of the fiscal year to ensure the organization stays under its budget constraints. During the fourth quarter, additional

funds and/or funds that were previously held in reserve for contingencies must be spent in full prior to the end of the fiscal year when the obligation period lapses.

To illustrate this point, Mark Kozar's (Kozar, 1993, page 132-133) data is used to compute the percentage change of obligation spending in the months of August to September (from 1977 - 1990). An increase of 54.15% is noted.¹ Thereby, when applying this percentage increase to the Fiscal Year 2005 Budget Authority (http://www.dod.mil/comptroller/defbudget/fy2005/fy2005summary_tables_part1.pdf) of \$141 billion available to DOD's Operations and Maintenance appropriation; we compute an increase of \$5.26 billion² was obligated in September.

Although this spending is potentially on lower priority items, it is physically impossible to determine exactly how much of the spending would be allocated to lower priority items. Past experience in dealing with military budgets and interviews conducted with eight different military officers tell us that a significant percentage is not necessarily wasted, but obligated toward requirements that may not be the highest priority.

A thesis written by Miller gives credence to the problem of appropriated funds being obligated on waste and lower priority items and illustrates a bigger problem that there is no financial incentive for a Commander to be cost effective. He states that, "Commanders must take painful steps to achieve efficiencies in day to day operations.

¹ $(10.616\% - 6.887\%) / 6.887 = 54.15\%$ increase in obligations

² $\$141 \text{ billion} \times (10.616\% - 6.887\%) = \5.26 billion increase in obligations

Even when they are inclined to search for extra efficiencies to return to the enterprise, Commanders have little financial incentive to find them because those who save money generally do not benefit from the savings. The Department of the Navy (DON) executes based on its annual budget. Failure to spend one's entire annual budget reduces the chance of maintaining that budget in future years. As a result, when budgets have not been spent in full (i.e., savings have been identified), then a nagging question is raised: does your organization need all of its funds? (Hale, 2002) Consequently, budgets are cut. Therefore, there is no fiscal incentive to achieve savings in the interest of the enterprise." (Miller, 2005, page 75-76).

Currently, a large part of the problem with O&M obligation develops during contingency spending. Recently during Operation Iraqi Freedom every activity was required to provide monthly itemized listings of all O&M funds obligated towards the war effort. The Type Commanders then reimbursed each activity the incurred costs when supplemental appropriations were received as a result of Congressional action.

It appears now when DOD executes a war it is done so on credit with a promise from the President and Congress to repay them for incurred expenses via a supplemental appropriation. In the meantime, DOD uses existing O&M funding to fund the war effort. In time, large sums of O&M funds are reprogrammed within DOD to pay for the war effort, and through the use of detailed data collection, DOD provides Congress an itemized bill for the cost of the

war. Congress pays the bill with a supplemental appropriation that repays DOD the O&M funds that were reprogrammed to pay for the war.

The supplemental funds are current-year as well as single-year funds. Therefore, DOD could potentially receive a significant amount of reimbursed O&M funding and have less than a quarter of a year to obligate it. These problems continue to exist during ongoing war efforts; in addition, DOD faces a similar situation in normal, peacetime operations, but to a much lesser degree.

Nevertheless, DOD faces the use or lose it predicament because it is given additional tasks every year...such as hurricane relief and tsunami relief plus the Global War on Terrorism (GWOT) etc. "For example, from 1990-1997, U.S. Naval forces participated in 50 major disaster missions. The duration of 12 of these operations lasted more than 2 years. Refugee support missions averaged over 3.6 annually, peaking at eight concurrent operations in 1994. From 1990 to 1993, 17 natural disaster missions were carried out. Between 1993 and 1997, 15 peacekeeping missions were undertaken. During the 1990's, the Navy evacuated embassy personnel from Liberia, Somalia, and Zaire; assisted refugees from Iraq, Cuba, China, Panama, and Rwanda; helped fight disease in Venezuela, helped people recover from storms in Antigua, the Philippines, Guam, Bangladesh, and the Bahamas; provided earthquake relief in the Philippines and Guam; aided the drought-stricken in Micronesia and Somalia; coped with volcanic eruptions in the Philippines and Italy; and was involved

with peacekeeping operations in Bosnia, Somalia, Liberia, Ecuador, and Haiti." (Jones and McCaffery, 2004, page 182)

This unpredictable effect on funding significantly impacts the financial position of every branch of the DOD. Large sums of expiring funds lead to timely execution problems and are the underlying issue that causes perceived, wasteful end-of-year spending or spending that is linked to lower priority items.

3. What are the Budgetary Dimensions of the Problem?

The budgetary dimensions of this problem have far-reaching implications with potential cost savings for the Department of Defense. These savings are not necessarily due to any reduced, end-of-year wasteful spending taking place, but mostly through the more efficient use of existing resources if the surge of funding could be obligated over a longer period of time.

To our knowledge and through our ongoing research, no programmed or budgeted funds have been applied towards the study of budgetary advantages and disadvantages of extending the obligation period of one-year appropriations. However, our research has revealed not only an interest in such a proposal, but on several occasions, the subject has been briefly discussed by various comptrollers we have talked with. For example, an interview with the Commander Naval Surface Atlantic (CNSL) Fleet comptroller revealed a recent board discussion which questioned why O&M money was only available for 12 months. Retired Navy Captain, John Mutty, now Professor at Naval Postgraduate School (NPS), and the Commander, Naval Surface Force Atlantic (CNSL) Comptroller both stated that the Secretary of Defense,

Donald Rumsfeld, recently testified before Congress about the potential savings of extending one-year appropriations to two years. Professor Larry Jones from Naval Postgraduate School (NPS) provided over 40 emails from various financial managers from around the world who briefly discussed this proposal and knew of no research ever conducted on this topic.

Our belief is that there are efficiencies to be gained and that DOD must challenge the paradigm. Do we have one-year appropriations simply because we have always had one-year appropriations? One identifiable objection to extending one-year appropriations to two years is the loss of power and influence by Congress and the idea that it would only solve the problem for one-year. Although no solution can fully resolve these issues, a well-crafted proposal with effective, minimum-requirement objectives could significantly improve the current situation.

II. BACKGROUND AND CONTEXT

How does DOD receive its current appropriations?
<http://www.senate.gov/reference/resources/pdf/97-684.pdf>

The United States Constitution, Article 1, Section 9 states, "No money shall be drawn from the treasury, but in consequence of appropriations made by law." The following paragraphs abbreviate the steps that Congress must perform prior to the President signing the appropriation bill into law and thus providing DOD budget authority³.

There are twenty budget functions in the federal budget. All of the budget functions are classified as discretionary or mandatory spending. Thirteen different appropriations make up the discretionary spending bills which causes much of the tension in the Congress. These thirteen different appropriations are presently equal to about one third of the federal budget. Mandatory spending makes up the remaining two-thirds of the budget and are authorized by permanent laws.

To start the process, the President sends his budget to Congress for the upcoming fiscal year on the first Monday in February. This is required by law. The DOD

³ Budget Authority: Authority provided by law to enter into financial obligations that will result in immediate or future outlays involving federal government funds. Budget authority includes the credit subsidy cost for direct loan and loan guarantee programs, but does not include authority to insure or guarantee the repayment of indebtedness incurred by another person or government. The basic forms include (1) appropriations, (2) borrowing authority, (3) contract authority, and (4) authority to obligate and expend offsetting receipts and collections. Budget authority may be classified by its duration (1-year, multiple-year, or no-year), by the timing of the legislation providing the authority (current or permanent), by the manner of determining the amount available (definite or indefinite), or by its availability for new obligations. (GAO, 1993, page 21)

budget is included in his submission, but is only a portion of the federal budget and one of twenty budget functions. The President recommends spending levels in the form of budget authority, which is legal authority to make obligations.

The Congressional Budget Office (CBO) usually has prior knowledge of the budget by this time and analyzes it for future economic impact analysis. Congress is interested in many issues, but among them is the forecast of the long-term budget deficit or surplus.
<http://www.senate.gov/reference/resources/pdf/97-684.pdf>

In March, the budget goes to the House Budget Committee and Senate Budget Committee. Their focus is to lay guidelines for the budget process, revenue, budget authority, surplus or deficit amounts and levels of public debt (Candrea et al, 2004). This is known as the Budget Resolution and is a concurrent congressional resolution between the House and Senate. April 15 is the deadline but it is rarely assembled in time, and if it is not completed, the prior year budget resolution is still in effect. Nevertheless, when this is completed, it is not signed by the President, nor is it law. It does not provide Budget Authority and is meant only as a guide for Congress, and in some ways it can be viewed as a formal response to the President's Budget.

Also starting in February, the Congress is tackling the Defense Authorization Act too. The House and Senate Armed Services Committee holds committee and subcommittee hearings so that programs have the authority to exist. If

passed, it will be signed into law by the President. However, the authorization bill does not provide budget authority.

Like the Budget and Authorization Bill, the House Appropriations Committee and Senate Appropriations Committee start hearings for the Defense Appropriations Bill in February. As stated earlier, there are 13 different appropriation bills that are signed into law, and all budget functions stem from these 13 different appropriations. "Appropriations provide the budget authority so we may incur obligations and expenditures. Without an appropriations act or Continuing Resolution Authority, we do not have budget authority. Upon completion of approval by both committees and both Houses of the Congress, the bills are forwarded to the President for his signature or veto." (Candрева et al, 2002, page 9)

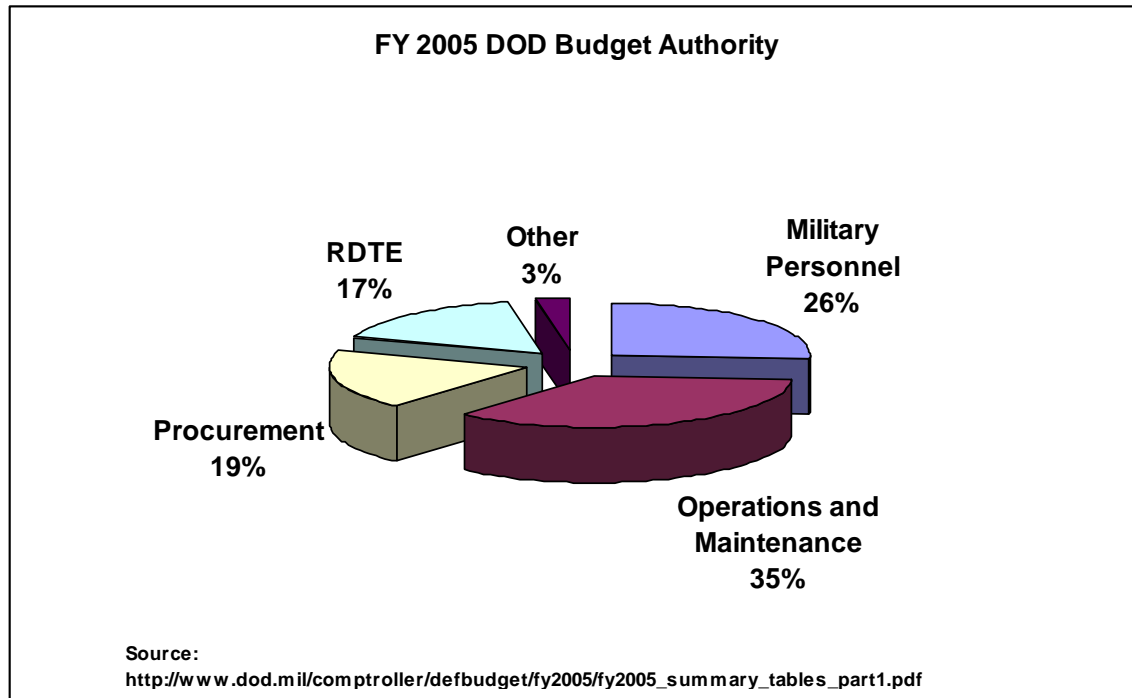
When an appropriation is passed, the Treasury issues a warrant for the amount of funds to be spent during the year and OMB apportions this amount to DOD. The Secretary of Defense uses allotments to delegate to the different components the authority to incur a specific amount of obligations. Following the allotments and allocations, obligations can be incurred (e.g. a contract let), and outlays can be paid when work or services are completed or equipment is delivered.

A. STAKEHOLDERS WHO ARE AFFECTED BY THE PROBLEM

Who has standing? Since O&M funds are the largest single appropriation for the military (as indicated in Figure 1), the stakeholders are varied and quite large because it involves every military organization funded with

O&M appropriations. However, the ultimate stakeholder is the taxpayer and they would benefit from more efficient use of O&M funds.

Figure 1. FY 2005 Budget Authority



Note: The DOD total budget authority for FY 2005 was \$402.6 billion.

From personal experience, some taxpayers are already somewhat suspicious of what DOD does with such large apportionments, especially when selective issues are given significant scrutiny by media. For example, the website <http://www.wherethemoney.org/> points out that money is being "frivolously" spent on "...\$1.1 trillion in unsupported accounting entries" and this headline "GAO Report Points to Pentagon Waste" (<http://www.washingtonpost.com/wp-dyn/articles/A36544-2005Jan25.html>) shows that the DOD is closely scrutinized. Therefore, one can see how the

American taxpayer grows skeptical with the government in general, and especially the Department of Defense, which has a never-ending list of critics lined up to probe for the newest scandal.

Other stakeholders who might gain from improved efficiency by extending O&M appropriations to 24 months are the air wings, submarines, surface ships and other operational units. Some of the items that O&M funds are used for are: air operations, ship steaming operations, mobilization forces, training, and administrative, etc.

The units that perform each of these functions would benefit from having more time to obligate the same amount of appropriated funds to ensure that they are getting the most efficient use of funds and not just carrying out the "use it or lose it" mentality. For example, in *Reinventing Government*, by Gaebler and Osbourne, "If they don't spend their entire budget by the end of the fiscal year three things happen: they lose the money they have saved; they get less next year; and the budget director scolds them for requesting too much last year. Hence the time honored rush to spend all funds by the end of the fiscal year." (Gaebler and Osbourne, 1993, page 3)

From personal experience, having to obligate additional funds and having large sums of unobligated funds at the end of the fiscal year can put a significant amount of stress on personnel trying to obligate these funds and can even lessen the integrity of the financial system. For example, most units are required to maintain a list of prioritized unfunded requirements with their type commanders. However, when money arrives from a higher

echelon, instead of spending money in accordance with the prioritized list, items are funded in an order in which funds can be obligated the easiest to meet the time constraint. For example, an interview conducted with an anonymous supply officer detailed how expiring funds were obligated quickly on lower priority items with National Stock Numbers (NSN). During normal operations higher priority items, which needed a detailed contract processed through the Fleet Industrial Supply Center (FISC), would take precedence over lower priority items. However, based on the limited available time to obligate the expiring funds, it was considered more essential to obligate these funds vice losing the money when the obligation authority expired. This is also an example of "use it or lose it" or "hurry up spending" as known to Congress.

In past fiscal years, additional funds would be parceled out to operational units from higher echelon commands just prior to 30 September. What happens next is what the general public would generalize as frivolous spending. In an attempt to maintain an existing baseline funding amount for the following fiscal year, operational units and higher echelon commands will make a concerted effort to obligate 100% of their funding, thus using their funds instead of losing their obligation authority.

As indicated by a GAO Report, (GAO Report, July 31, 1998, page 2), which highlighted year-end spending; the Senate Subcommittee on Government Management held hearings and issued a report, Hurry-Up Spending, to address problems with federal spending practices and the award of government contracts. The Subcommittee found that the "rush to

obligate expiring funds at the end of the fiscal year ...frequently resulted in a lack of competition, poorly defined statements of work, inadequately negotiated contracts, and the procurement of low-priority items or services."

The GAO report goes on to explain how wasteful year-end spending can occur when agencies rush to use funds at the end of the fiscal year. "This is often an attempt to spend funds that would otherwise expire, meaning they would no longer be available for new obligations after the fiscal year ends. In its 1980 report, the Subcommittee recognized that higher fourth-quarter obligations may not indicate a problem with wasteful spending. The Subcommittee noted that spending at year-end may be the result of legitimate, planned, and worthwhile spending intended by Congress. However, the Subcommittee found numerous examples in which agencies took shortcuts in the last few weeks of the fiscal year that led to questionable contracts. Hurry-up procurement practices resulted in the purchase of millions of dollars worth of goods and services for which there were no demonstrated current needs. The Subcommittee found that to spend quickly, the government frequently paid inflated prices, incurred higher administrative costs for overtime, and awarded contracts that were not in the government's best financial interest." (GAO Report, July 31, 1998, page 2)

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III. DATA AND STATISTICAL ANALYSIS

This project uses data drawn from Mark Kozar's thesis to indicate the dimensions of the rush to spend at the end of the fiscal year using data from the 1977-1990 time frame. The statistical analysis of his 14 years of fiscal data pulled from DOD O&M accounts will establish the base for which conclusions will be drawn and recommendations determined.

Mark Kozar studied O&M Total Obligation rates for a 14-year period, from 1977 to 1990. Table 1 data displays each month starting in October through September. (Note: October is the start of the new fiscal year. January, April, and July are the first months of each new quarter.)

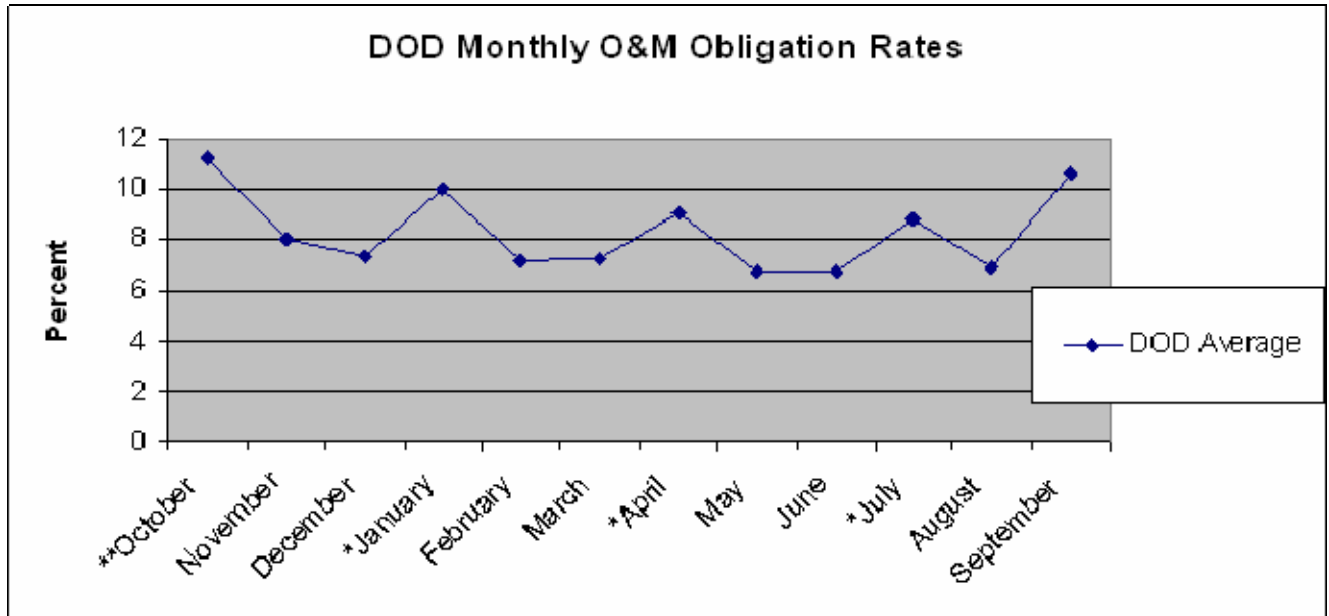
Table 1. Average DOD Operations and Maintenance
Monthly Obligation Rates with High-Low Ranges
(Percent) 1977-1990

Month	DOD Average	High	Low
**October	11.235	12.3	9.83
November	8.018	9.73	7.03
December	7.346	8.18	6.47
*January	10.048	11.42	8.11
February	7.165	8.35	6.1
March	7.223	7.96	5.65
*April	9.083	10.61	8.3
May	6.708	7.61	6.09
June	6.726	7.49	5.89
*July	8.778	10.57	7.43
August	6.887	7.39	6.17
September	10.616	12.05	9.78
Total	99.833		

Source: Kozar, 1993, pp. 132-133

Figure 2 graphically displays the averaged data from Table 1 by month.

Figure 2. DOD Monthly O&M Obligation Rates



Source: Kozar, 1993, pp. 132-133

In general, the first and last months of the fiscal year are the highest spending months. October generally surges because of new contracts being let. Traditionally, spending is low in the summer as year-end positioning takes place, and September is relatively high as managers rush to spend their funds on planned and unplanned needs. October shows the highest rate of commitment of funds (11.235%), and September illustrates the end-of-year spending surge. September was the second highest individual month, and the rate of change from the preceding month of 53.6%⁴

⁴ $(10.616\% - 6.887\%) / 6.887\% = 53.6\%$ increase in obligations

exceeded any other rate of change between two months. The fact that August has a low obligation rate helps create this relationship.

(Jones & McCaffery, 2004, page 216)

The analyzed data above is typical of what you would see and expect from various units throughout DOD. On average, September is well above the normal obligation rates as compared to the other quarter-ending months. For example, as indicated in Table 1, the quarter-ending months December, March and June spent on average 7.098%⁵ of the total fiscal year budget. This is significantly less when compared to September's average of 10.616%, an increase of 49.560%⁶ of the entire fiscal year budget. What would be the effects if one-year appropriations were extended to twenty-four months? Potentially, implementing this change would cause September to resemble the other end-of-quarter months and make it look less like an outlier.

Additionally, when comparing September's obligation rate with the other eleven months' averaged obligation rates, September has an increase of 30.580%⁷. However, the overall analysis of this collected data only reveals the quantity of purchases and not the quality.

Table 1 reveals that the DOD, as an aggregate, obligates funds accurately, almost flawlessly. The total DOD O&M obligation rates were 99.833%. Stated another way, Congress has appropriated a certain amount of funding for

⁵ $(7.346\% + 7.223\% + 7.726\%) / 3 \text{ months} = 7.098\%$ average of quarter ending months

⁶ $(10.616\% - 7.098\%) / 7.098\% = 49.560\%$ increase in obligations

⁷ $(10.616\% - 8.126\%) / 8.126\% = 30.640\%$ increase in obligations in September.

O&M, and DOD has obligated that money within the constraints and within hundredths of one percent. It appears as if DOD simply obligates funds because it is culturally acceptable to obligate all appropriated funds to zero. While this may seem trivial, it raises some interesting questions. At the end of fiscal year, does the DOD always obligate appropriated funds according to highest priority requirement? Would DOD obligate funding on the same items that they currently do if there was a mechanism in place that would allow DOD to carry forward a maximum of 20% from this fiscal year to the next?

After conducting eight separate interviews with Naval Supply Corps Officers, the answer to both questions is "no". Additionally, all eight officers said that if they had had an incentive not to spend and had available to them the ability to roll excess funding forward to the next fiscal year, they would have been more critical with all these obligations.

The Supply Officers surveyed were then asked, "If biennial appropriations were approved by Congress, would that action cause them to obligate funds more critically?" By definition biennial budgeting only changes the times on which the budget is voted on, which in this case is every two years. Therefore, after learning the definition of the biennial budgeting, all answered that their obligations under this situation would not change because the resulting appropriation would mirror the present-day annual routine.

Would a multi-year or a two-year appropriation provide logisticians the ability to obligate funds more critically? Their answers were that they would still be forced to

obligate to zero all appropriated funds every two years. This does nothing more than push the annual rush to spend out to two years from the current annual ritual to spend-out to zero. The proposal we present later in the project provides guidance to prevent the annual rush to spend.

Although the interviewed officers agreed additional time to obligate expiring funds would be beneficial, there was an underlying concern that any change would evaporate these additional funds they receive annually. Would Type Commanders hold most of these formally expiring funds for their centrally funded requirements? Consensus is that although all expiring funds are not completely obligated towards the highest priority items they still fill a much needed funding void for ships to fill lower priority needs necessary to meet minimum daily requirements.

Moreover, the current way things are done exacts a toll on personnel. Here is a list of dysfunctions which occur to normal operating patterns because of use it or lose it pressures:

- Commanding Officers, who would normally be upset when sailors work late because of "quality of life" issues, do not second guess a decision to work late in order to obligate funding by midnight, 30 September.
- Fleet Industrial Supply Centers (FISC) have historically worked extended hours during the last week of the fiscal year in order to provide service to the fleet.
- Every contracting shop has stories about the end-of-year contracting extravaganza and takes pride in being viewed as doing their part to support the fleet. It

is a common philosophy for a contracting shop to perform in an exceptional manner that will prevent it from being responsible for causing a unit from obligating its full Operating Target (OPTAR) budget. So at the end of the fiscal year, most contracting personnel can expect to work many additional hours to provide service to the military units in order to obligate their expiring funds.

- Comptrollers and military officers automatically assume that their personnel have bought into the paradigm of staying late and fully obligating their OPTAR. Young, inexperienced, enlisted personnel are the only ones who question the paradigm of staying late the last few days of the fiscal year. This question seems to raise eyebrows around the office and is almost laughable, but their minds are quickly changed. By the next fiscal year, they are indoctrinated into the normal way the DOD "does business".

It seems as if obligating all their OPTAR on 30 September provides them a sea story about the unforgettable spending spree, and it becomes a rite of passage, defining a way of life for all financial managers and their subordinates.

Not only does the existing policy of "use it or lose it" generate a significant amount of perceived and real fiscal waste, but it also places undue stress on sailors, supervisors, and military family members. With the increased deployment requirements being demanded from all military members, is it necessary to burden them with

additional time-consuming duties created from outdated appropriation policies and obligation mismanagement at many different levels?

A. EXTENDING OPERATIONS AND MAINTENANCE APPROPRIATIONS VS. MULTI-YEAR AND BIENNIAL APPROPRIATIONS

It is important to note that this is not a proposal to change one-year appropriations to two-year appropriations, nor is it a proposal to have biennial budgeting, but only a proposal to extend the obligation life of the appropriation. A recent study, generally favorable towards biennial budgeting, concedes that biennial budgeting "entails some loss of...legislative control." (Whalen, 1995-1996, page 18) This research effort views biennial budgeting unlike that of extending the single year appropriation. Receiving Congressional support of a proposal to extend the obligation period vice changing it to a biennial budget is more likely because it still requires DOD to seek annual budget approval; thus maintaining existing Congressional control. Additionally, the same can be said for the multi-year appropriation proposal.

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IV. PROPOSAL

Our proposal centers on extending O&M one-year appropriations to 24 months with spending limits and requirements. Congress would still be required to appropriate O&M money annually; however, the funds that are appropriated would increase its obligation life by 12 months to a total of 24 months. It is important to note that this is not a proposal to change one-year appropriations to two-year appropriations or biennial budgeting, but only a proposal to extend the obligation life of the appropriation. A previously mentioned study, generally favorable towards biennial budgeting, concedes that biennial budgeting "entails some loss of...legislative control" because the legislature passes a budget every two years instead of one. (Whalen, 1995-1996, page 18)

Extending the obligation life would require financial personnel to track both the remaining 12 months of expiring fiscal year funding plus the full 24 months of the newly provided O&MN funding. Although the tracking of old and new fiscal year funding at the same time would be new for most comptrollers it is normal practice for procurement and RDT&E comptrollers; thus, sharing of ideas, technology and lessons learned would be a requirement for a smooth transition. Additionally, ships' financial personnel currently track O&M funding for three years via Summary Filled Order/Expenditure Difference Listing (SFOEDL); therefore, the tracking of current year and prior years' budgets would only add minimal additional oversight.

Our proposal would require financial managers to obligate, at a minimum, 80% of their total O&M funding in the first 12 months of the new appropriation. Congressional law currently requires financial managers to "monitor the twenty-two rule" which states that you are prohibited from obligating more than 20 percent of your budget authority in the last two months of the fiscal year. "This is a general provision of each Authorization Act. This rule is directed as a general provision in the DOD Appropriations Act and monitored by USD(C) at the appropriation level. Obligations for the fourth quarter are not to exceed the obligations of the third quarter, and orders for supplies will be kept to essentials only-recall the bona fide needs rule for appropriations" (Candрева et al, 2004, page 119).

Current obligation rates, (100% by the end of 12 months) would be changed to reflect the minimum obligation requirements in Table 2 and 3. The remaining 20% is spread out over the last 12 months and requires quarterly obligation thereafter of at least 5% until 100% is obligated. At any time along the way if a unit is unable to justify why it is falling behind the obligation rates, then it would result in higher echelon reprogramming of excess funds.

Table 2. Required Obligation Rates for Extending to 24 Months Appropriations Proposal

Month	End of Month 12	End of Month 15	End of Month 18	End of Month 21	End of Month 24
Obligation Rate	>= 80%	>=85%	>= 90%	>= 95%	100%

As stated above the "twenty-two rule" is already in effect and would require Congressional effort to change the obligation percentages required by law. The requirements for the rule would change and so should the name. The recommended name change proposed would be the "80/20 Rule". The spirit and intent of the law would be that 80% of the appropriated funds would be obligated in the first 12 months and would therefore leave 20% to be obligated over the remaining 12 months as seen in Table 2 and Table 3.

Table 3. Proposed Total Obligation Rates by Fiscal Year

	Year 1	Year 2				Total Appropriated		
2004	80%	20%				100%		
		Year 1	Year 2					
2005		80%	20%			100%		
			Year 1	Year 2				
2006			80%	20%		100%		
				Year 1	Year 2			
2007				80%	20%	100%		
Total Obligations	80%	100%	100%	100%				

Note that in the transition year, (year 1) the obligation rate could be in the high 90's. The proposed change only requires that obligations must be at least 80%. These are minimum thresholds.

For those who feel our 80-20 rule is adding complexity to complexity, we suggest another alternative which is to simply create the O&M account like the existing RDT&E account and let the patterns which govern it, govern the

new two year O&M account. In 2003, the RDT&E account obligated 90.22 percent in year one and 9.78 percent in year two. This also would be a viable way to correct the end of year obligation surge with the added advantage of modeling on procedures already in place within DOD.

V. BUDGETARY ADVANTAGES/DISADVANTAGES OF EXTENDING THE OBLIGATION PERIOD FROM ONE-YEAR APPROPRIATIONS TO 24 MONTHS

A. CONTROL

1. (DOD Advantage)

Military/Civilian administrators would have more control over funding issues than current appropriation laws allow. Our proposal of changing the appropriation law would allow financial managers the ability to obligate O&M funds over a 24 month window vice a 12 month window.

Currently the budget is allocated for a particular fiscal year and the law prevents left over funds from being carried forward into another fiscal year. Because the budget for the next fiscal year is based in part from the actual expenditure from the previous fiscal year there is no incentive to end the fiscal year with additional funds out of fear of a budget reduction. As a result, during the financial year, budget personnel manage budgets carefully by scrutinizing all expenditures in the beginning out of concerns of exceeding budget authority. As the fiscal year nears its end, there is pressure to obligate these accumulated funds at all costs. The annual ritual begins when every divisional supply representative is briefed on what to expect, "have all your requirements in by this date so expiring funds can be quickly spent."

This proposal provides an additional 12 months to obligate expiring funds and provides financial managers the flexibility to closely scrutinize the obligation of funds towards items deemed a bona-fide need. It is our thought

that removing the strict requirement of obligating 100% of O&M funding in 12 months will alleviate the lower priority end-of-year spending and the "use it or lose it" philosophy. Possibly there could be an isolated case where financial managers could not meet the 80% obligation rule within the first 12 months, but the overwhelming majority could easily do so. Additionally, having the new fiscal year funds arrive annually completely eliminates the need to hold expiring funds for unexpected contingencies. Additionally, an experienced financial manager knows to obligate these expiring funds before using any of the newly arriving funds; therefore, preventing a future budget crunch to spend expiring funds at each of the proposed deadlines.

2. (DOD Advantage)

Extending the obligation period to 24 months would provide more decision-making flexibility (or power) to those who need it most, operators in the field and the sailors onboard ships. Today's supply officers have a myriad of daily, difficult time-consuming problems, ranging from personnel issues to tracking depot level repairables (DLR) in addition to having to communicate daily with shore-based facilities for logistic support. Comptrollers or supply officers with an extended obligation period for O&M funds would immediately notice the difference:

- The increased obligation period would allow them to critically evaluate each requirement against a prioritized unfunded list. Currently, this list is generated, routed through the chain of command and filed with the Type Commander. Funds are not always spent in accordance with an approved requirements

list or in accordance with the highest priority needs, but instead funds are sometimes spent on lower priority items solely because the O&M funds can be obligated towards them the quickest.

- Currently, under existing appropriation laws, units lose the ability to recapture and obligate funds from prior fiscal years. For example, DLR charges at or near the end of the fiscal year represent funds lost due to the lengthy challenge process. Once the charge has been reversed and has been credited to the ships Operating Target, the obligation authority is lost because it is posted to the prior fiscal year. Extending the appropriation period would give the unit the opportunity and flexibility to obligate these recovered funds for current fiscal year requirements. Many of today's high technological DLR's are extremely expensive and can easily exceed several hundred thousand dollars for one circuit card in FY05 funds.

3. (DOD Advantage)

Operational units and organizations are often required to hold significant funds for potential contingency operations. Under current law, when the end of the fiscal year nears, activities play an annual guessing game of deciding how much funding to hold and when is the best time to spend current year funding prior to the end of the fiscal year. With an additional 12 months to obligate:

- OPTAR holders have the ability to hold funds beyond the end of the fiscal year without the fear of losing the obligation authority.

- The added flexibility alleviates the concern of not being able to fund contingency operations if too much funding is obligated prior to the end of the fiscal year.
- The added flexibility alleviates the loss of obligation authority when funds go unspent due to time constraints.
- Additional obligation time allows units the opportunity to obligate recovered funds from carcass charges resulting from successfully challenged DLR's.

4. (DOD Advantage)

Overspending is another problem that occurs with the frantic spending of expiring funds, and thus, increases the risk of Anti-Deficiency Act violations. Currently, when additional apportioned funds are received from higher echelons near the end of the fiscal year, financial managers experience pressure of being "under the gun" to spend quickly just to obligate all funds, sometimes in less than 12 hours. Extending the obligation period of O&M appropriations to 24 months would result in more time to strategically spend money on equipment and supplies that are bona fide needs and current-year use.

5. (Congressional Advantage)

Congressional leaders gain legitimate power from their ability to appropriate funding to whatever programs and constituents they decide. They currently have dynamic fiscal authority in a way that they are able to indirectly control the President's foreign policy (by way of appropriating O&M funds annually) and can indirectly establish the Pentagon priorities. Extending one-year

appropriations to 24 months would be, in essence, Congress maintaining their control and power. This is an opposite effect of what would happen if Congress adopted two-year appropriations or biennial budgeting. This is because DOD would still be required to seek budgetary Congressional approval annually by way of appropriations law.

B. INCENTIVES

1. (DOD/Congressional Advantages)

With the extension of appropriations to 24 months, financial managers would be allowed to carry money forward into the next fiscal year. This is an incentive for them to save money for future needs and to obligate wisely at a controllable pace. The current incentive is to spend funds quickly and obligate to 100% of the appropriation or risk receiving smaller apportionments in future fiscal years.

2. (DOD Advantage)

Currently, at the end of the fiscal year when spending waste occurs, goods which are labeled as "nice to have", a.k.a. lower priority items, are routinely purchased mainly because obligation can occur quickly. This is significant because an item that has a stock number or is available through a prime vendor can be obligated within minutes. However, higher priority items that require contracting assistance (outside of the command) can take days and sometimes weeks to obligate funding. Because additional funding usually becomes available days before the appropriation expires, an air of urgency is present to spend 100% of available appropriated funds to prevent loss and thereby lowering the baseline. An extension to 24-month O&M appropriations will jeopardize the purchase of these "nice to have" items. This is because the purchase

of these items will rise to the level of a higher priority item. Most likely the unfunded requirements list will grow and only shorten when these lower priority items move higher up in priority. The bottom-line on this advantage is that if there is an incentive (such as extending O&M appropriations to 24 months) to carry funds forward into the next fiscal year, the "nice to have" items will typically go unfunded, thereby improving the efficiency of the obligated DOD funding.

C. PUBLIC PERCEPTION

1. (DOD Advantage)

The listed advantages so far have all been centered on the end user. Through the use of rigid spending guidelines, higher echelons would require goals of specific obligation percentages be satisfied as opposed to our current spending rates of 100% in 12 months. This would lead to better use of funds, and also improve the perception of the military as being good stewards of taxpayers' money by eliminating the current end-of-fiscal year spending frenzy.

2. (DOD Advantage)

Total O&M appropriations from 1977 to 1990 showed a mean percentage increase of obligations from August to September of 49.560%⁸. Was this notable increase due to the incompetence of the financial manager to spend all of his apportioned funds during the fiscal year, or was it proof he could spend funding efficiently towards bona fide needs? Public perception would probably err on the side of incompetence and say that it is another example of "use it or lose it" spending. An extension to 24 months would

⁸ $(10.616\% - 7.098\%) / 7.098\% = 49.560\%$ increase in obligations

encourage financial managers to use funding on items that are considered higher priority instead of having to choose to obligate the funding on lower priority goods due solely to time constraints.

3. (DOD Advantage)

Support personnel such as those working at the Fleet Industrial Supply Centers and the Defense Depots annually plan for the end-of-fiscal year spending. Logistics, contracting, and warehousing experts routinely work long hours of overtime to support the military's rush to obligate. Extending the obligation period of O&M funds would help generate savings from less overtime worked. Further research is required to indicate the possible amount of savings generated from working less overtime.

4. (DOD Disadvantage)

Federal employees and contractors who depend on working the extended hours during end-of-fiscal year spending may perceive the fewer hours worked as a threat to their livelihood. Initially, this could create a negative work environment until the new norm is established.

5. (Congressional/DOD Advantage)

The thesis written by Williams (W6166, p.3) states, "the intent of increased oversight and control is to ensure that the intent of Congress is carried out by the executive branch." However, this intent sometimes results in unintended consequences as noted by Williams, "the impact of congressional oversight and control, and the detail to which this oversight and control is exercised, appears to be counterproductive to the achievement of the ends desired by Congress, because the burden of excessive congressional

management often impedes the Navy acquisition and budget execution efficiency and effectiveness."

One critical requirement demanded from financial managers is their ability to operate in a manner that avoids negative public perception. Anti-Deficiency Act violations are occurrences that lead to such negative public perception and heighten the perceived need for additional Congressional oversight. Cheney noted (page v, C4145) "It is important that in our pursuit of scarce dollars, the people who provide us the money trust that we will be good stewards of the money. Negative public and Congressional perceptions jeopardize Navy funding. As responsible stewards of taxpayers' money, we must strive to obtain the optimum use of our resources, within the limits of the law. Congress implemented a series of laws designed to prevent government officials from spending the taxpayers' money in a manner that Congress did not intend. Collectively, the laws are referred to as the Anti-Deficiency Act. Execution of the budget contrary to the Anti-Deficiency Act is a violation of federal law. Each violation damages the public perception that the Navy is a good steward of the taxpayers' dollar, which could influence the amount and the degree of Congressional control and oversight of future funding."

D. MORALE/TRAINING ADVANTAGE

1. (DOD Advantage)

Employee morale would most likely increase due to the elimination of long-hour days required to obligate end-of-year funding. Personnel who work for financial managers typically work until midnight frantically obligating funds on 30 September and many additional hours leading up to

fiscal year's end. A 24-month appropriation would alleviate the need for long hours leading up to this annual ritual. Proper and sensible obligation of O&M funding within the 24-month goal would result in a normal work day for most logisticians, financial managers, accountants, contractors, and warehousing personnel. Additionally, this proposal would reduce the variability currently experienced within the supply chain when large quantities of supplies are pushed through the system in October as a result of the September spending binge. The quantity of material moved in October should mirror that of the other eleven months because of the 24-month appropriation.

2. (DOD Disadvantage)

Currently, the non-logistician personnel enjoy the Christmas-in-September spending atmosphere. At no other time does the high level of obligation scrutiny go on vacation as it does now in late September. One would be hard pressed to find favor for this proposal from anyone outside the realm of logistic and financial personnel. However, the impact on crew morale should be slight and actually gain support when confronted with the facts that this is the right thing to do.

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VI. CONCLUSION

The direction provided by Admiral Vern Clark, Chief of Naval Operations (CNO) in "Sea Power 21", indicates the need to resource tomorrow's fleet. "Among the critical challenges that we face today are finding and allocating resources to recapitalize the Navy. We must replace Cold War-era systems with significantly more capable sensors, networks, weapons, and platforms if we are to increase our ability to deter and defeat enemies." (Proceedings, 2002) He states our "Navy values operational excellence as its highest priority and the vast majority of our training is devoted to sharpening tactical skills. However, it is also important that our leaders understand sound business practices so that we can provide the greatest return on the taxpayer's investment." (Proceedings, 2002)

The analysis of reforming the O&M account to a 24 month appropriation is straightforward and falls in line with what the CNO has directed above. The authority to obligate funds an additional 12 months should reduce spending in September. Adoption of this proposal should eliminate the annual, end-of-year, spend-out, "use it or lose it" phenomenon where real spending priorities are ignored in a rush to obligate all remaining funds. This also would provide program managers and organizations the ability to execute budgets more efficiently with greater attention to overall DOD mission without the fear of losing flexibility or funding. Additionally, this change would

provide for the efficient use of manpower, reduce overtime, improve morale and create a consistent way of doing business year round.

Existing experience in handling multiple-year appropriations (such as procurement and RDTE) is currently available for assistance and will provide lessons learned. Currently there are a small percentage of financial professionals who maintain multi-year appropriations. Further study is needed to determine exactly how much, but indications are this change would lead to a larger percentage of financial personnel required to handle multiple-year appropriations. However, in order to insure a smooth transition for them to handle multi-year appropriations it would be necessary to use these lessons learned and hold proper training as necessary.

A. WHO HAS TO BE INVOLVED IN FINDING RESOLUTIONS TO THE STATED PROBLEM?

The problems with finding resolutions to these existing financial barriers are many, but this one proposal could help transform the DOD. Sometimes the right people are not always involved in finding a solution to a problem. Many solutions may be available, but if there is not anyone to champion the cause then the greatest initiative able to solve a problem is just an idea. Therefore, in order for an idea such as this to be successful, cultural barriers and paradigms need to be shattered. The necessary changes needed for difficult cultural shifts require significant involvement by people of influence, those who will guide and direct these potential improvements into implementation.

People in the field, who understand the problems and limitations of the current systems, must be forthcoming and willing to challenge the status quo and push forward alternatives and radically new ideas. Those who understand the system best are the military and civilian comptrollers, and they can best logically present advanced ideas that can work most efficiently within the financial mechanisms.

The idea of extending annual appropriations to 24 months has wide-reaching appeal to financial managers. However, the financial managers require assistance from academia and students of government financial management to further this research on proposed ideas and possible solutions. Many professors have personal contacts that can directly or indirectly apply pressure along with subject matter influence that will help "push the envelope" a little further along. Proposals move forward when an institution such as the Naval Postgraduate School (NPS) in Monterey, California, decides to commit significant teaching time to revolutionary ways and ideas that lead to increased fiscal accountability and financial readiness. Additionally, professors at NPS have access to the Conrad Chair.

The Conrad Chair was established in 1986 to foster a robust relationship between the Office of the Assistant Secretary of the Navy (Financial Management and Comptroller) (OASN (FM&C)) and the financial management program at the Naval Postgraduate School. The objective is to enhance professional development opportunities for faculty and students, and conduct and direct research supportive of the OASN (FM&C) in areas of resource

management. The Conrad Chair is charged with enhancing the academic and practical capabilities of graduates to assume critical financial management positions in the Department of the Navy. (http://www.defenselink.mil/releases/2000/b04192000_bt198-00.html) The ASN FM&C then has a working relationship with SECNAV and SECDEF. From within this level of DOD, political influences can be leveraged to seek change.

In finding a resolution, Congress may be apprehensive about finding a solution that could potentially cause a loss of power. Extending O&M appropriations from 12 to 24 months could be viewed as significantly reducing Congress' ability to maintain the "power of the purse." Congressional members are obviously aware of this and would probably scoff at such proposals.

However, an extension of obligation period to 24 months allows Congress the ability to maintain its present "power of the purse" with the following caveats:

- Annual appropriation bills would be approved as they are currently.
- 80 percent of appropriations would be required to be obligated in the first 12 months.
- The remaining 20 percent of appropriated funds could be obligated in the following 12 months (or the next fiscal year).

Nevertheless, Congress realizes they have this power and will not relinquish it unless there is a more efficient alternative than the status quo. Anything less would compromise their treasured authority and their "power of the purse".

Additional issues requiring further investigation:

- Determine if there is a way to quantify end-of-year spending by the level of scrutiny received. Currently very little is applied due to the urgency to fully obligate all funds.
- Determine if there is a way to measure the level of Congressional support for this proposal and the best way to package it for submission.
- How can this issue be part of DOD's bigger transformation plan that will move the military forward into the next century?

The most significant impact of this proposal would occur within the program's budgetary funding line. The results will lead to improved efficiency with obligations and will most likely allow for some cost savings. The President has suggested, the time has come... "to give DoD greater ability to shift funding from lower to high priorities during this period of increased military operations. Also needed is to make O&M funds available for two years to help the department ensure, during budget execution, that funding goes to the military's most pressing readiness, training and support requirements." (<http://www.defenselink.mil/cgi-bin/dlprint.cgi?http://www.defenselink.mil/releases/2004/nr20040202-0301.html>)

Would a proposal like this result in decreased program line funding reductions or increased scrutiny from Congress? One would caution against reductions because removal of the incentive to save would only push units of DOD to revert to the existing philosophy of "use it or lose

it". Any savings carried forward to the next fiscal year under this proposal resulted from sound business decisions and should not be used as indicators to reduce future funding.

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